## MISCELLANEOUS

| | Merchandise Trade Balance | | Leading Indicators | | Estimated GNP | | Estimated GNP (1982 $) | | IVA (annual rate) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| January 1987 | -12.27 | -12.27 | 186.0 | 185.6 | 4308 | 4346 | 3714 | 3753 | 9.9 | 14.6 |
| February | -15.06 | -15.07 | 186.8 | 186.3 | 4349 | 4385 | 3743 | 3777 | -7.7 | 9.6 |
| March | -14.15 | -13.63 | 187.5 | 187.7 | 4361 | 4402 | 3743 | 3779 | 7.6 | 9.7 |
| April | -14.89 | -13.32 | 188.3 | 186.6 | 4372 | 4420 | 3740 | 3781 | -8.0 | 14.9 |
| May | -14.50 | -14.40 | 187.8 | 187.5 | 4398 | 4452 | 3749 | 3799 | -8.3 | 19.6 |
| June | -14.21 | -14.00p | 187.7 | 188.0 | 4423 | 4474 | 3758 | 3804 | -8.6 | 21.0 |
| July | -14.96 | -13.26* | 188.0 | 188.6* | 4440 | 4495* | 3763 | 3818* | 9.8 | 22.7* |
| August | -14.70 | -13.63 | 187.7 | 188.9 | 4465 | 4527 | 3771 | 3823 | -10.2 | 20.3 |
| September | -14.44 | -13.29 | 188.3 | 189.4 | 4491 | 4552 | 3780 | 3832 | -9.3 | 16.5 |
| October | -14.08 | -13.53 | 187.7 | 189.0 | 4516 | 4576 | 3789 | 3836 | -10.5 | -14.2 |
| November | -13.91 | -12.96 | 187.5 | 188.6 | 4535 | 4608 | 3795 | 3850 | -10.8 | -11.6 |
| December | -13.73 | -12.85 | 187.9 | 189.1 | 4557 | 4635 | 3801 | 3859 | -11.1 | -11.9 |
| January 1988 | -13.68 | -12.29 | 188.4 | 188.7 | 4582 | 4656 | 3806 | 3863 | -15.4 | -12.5 |
| February | -13.51 | -13.41 | 188.5 | 188.2 | 4610 | 4682 | 3810 | 3870 | -17.6 | -12.8 |
| March | -13.33 | -12.58 | 188.2 | 187.8 | 4633 | 4715 | 3810 | 3884 | -19.8 | -15.3 |
| April | -13.26 | -12.26 | 187.8 | 187.2 | 4660 | 4739 | 3823 | 3888 | -16.5 | -18.1 |
| May | -13.53 | -13.05 | 187.3 | 188.0 | 4686 | 4764 | 3835 | 3895 | 15.4 | 16.6 |
| June | -13.26 | -12.57 | 187.0 | 188.3 | 4716 | 4788 | 3847 | 3899 | -14.6 | -15.2 |

Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections

## CONSTRUCTION

| | Housing Starts | | Single Family Starts | | Housing Permits | | Construction Expenditures (Current) | | Construction Expenditures (Real) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| January 1987 | 1.816 | 1.816 | 1.253 | 1.253 | 1.690 | 1.690 | 374.8 | 384.7 | 339.0 | 343.9 |
| February | 1.833 | 1.838 | 1.299 | 1.303 | 1.763 | 1.676 | 378.4 | 401.6 | 341.3 | 355.3 |
| March | 1.774 | 1.749 | 1.245 | 1.226 | 1.757 | 1.719 | 375.2 | 388.3 | 337.7 | 341.5 |
| April | 1.767 | 1.699 | 1.225 | 1.250 | 1.698 | 1.599 | 375.9 | 397.3 | 337.4 | 349.2 |
| May | 1.718 | 1.602 | 1.189 | 1.119 | 1.653 | 1.493 | 376.2 | 398.6 | 336.8 | 349.6 |
| June | 1.654 | 1.590 | 1.138 | 1.092 | 1.589 | 1.514 | 375.7 | 394.0* | 335.4 | 345.0* |
| July | 1.642 | 1.592* | 1.130 | 1.116* | 1.564 | 1.498* | 375.0 | 391.8 | 333.9 | 342.8 |
| August | 1.642 | 1.595 | 1.132 | 1.122 | 1.541 | 1.507 | 373.4 | 389.5 | 331.6 | 339.9 |
| September | 1.629 | 1.595 | 1.119 | 1.113 | 1.527 | 1.501 | 372.1 | 389.6 | 329.9 | 338.8 |
| October | 1.610 | 1.580 | 1.106 | 1.107 | 1.506 | 1.473 | 371.3 | 389.7 | 328.3 | 338.3 |
| November | 1.586 | 1.593 | 1.096 | 1.123 | 1.485 | 1.488 | 371.4 | 389.3 | 327.2 | 337.1 |
| December | 1.580 | 1.548 | 1.087 | 1.095 | 1.488 | 1.427 | 371.3 | 390.5 | 326.0 | 337.5 |
| January 1988 | 1.618 | 1.558 | 1.105 | 1.086 | 1.531 | 1.439 | 372.4 | 390.4 | 326.1 | 336.6 |
| February | 1.632 | 1.553 | 1.126 | 1.080 | 1.553 | 1.462 | 373.1 | 390.2 | 326.1 | 335.8 |
| March | 1.607 | 1.561 | 1.108 | 1.089 | 1.528 | 1.471 | 374.4 | 389.9 | 326.4 | 334.7 |
| April | 1.590 | 1.552 | 1.102 | 1.076 | 1.507 | 1.456 | 376.4 | 390.2 | 327.3 | 333.8 |
| May | 1.589 | 1.559 | 1.109 | 1.082 | 1.493 | 1.463 | 378.6 | 391.3 | 328.4 | 333.9 |
| June | 1.585 | 1.582 | 1.104 | 1.094 | 1.495 | 1.489 | 380.9 | 392.4 | 328.9 | 334.0 |

| | Non-Residential | | Public Construction | | Residential Construction | |
|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| January 1987 | 118.2 | 122.4 | 75.1 | 74.5 | 181.5 | 187.8 |
| February | 121.0 | 123.4 | 78.0 | 75.2 | 179.4 | 203.1 |
| March | 118.1 | 121.4 | 75.1 | 76.1 | 182.0 | 190.8 |
| April | 117.4 | 121.4 | 76.0 | 76.7 | 182.5 | 199.2 |
| May | 116.8 | 123.8 | 76.6 | 75.8 | 182.8 | 198.9 |
| June | 116.1 | 123.0* | 77.2 | 76.1* | 182.4 | 194.9* |
| July | 116.5 | 122.4 | 77.8 | 76.5 | 180.7 | 192.9 |
| August | 116.0 | 121.8 | 78.2 | 76.4 | 179.2 | 191.3 |
| September | 115.7 | 120.9 | 78.7 | 77.0 | 177.7 | 191.7 |
| October | 115.3 | 120.3 | 79.1 | 77.3 | 176.9 | 192.1 |
| November | 115.8 | 120.0 | 79.6 | 77.6 | 176.0 | 191.7 |
| December | 115.9 | 120.4 | 78.9 | 78.1 | 176.5 | 192.0 |
| January 1988 | 115.7 | 120.1 | 79.6 | 78.6 | 177.1 | 191.7 |
| February | 115.5 | 119.7 | 80.1 | 78.8 | 177.5 | 191.7 |
| March | 115.8 | 119.4 | 80.7 | 79.4 | 177.9 | 191.1 |
| April | 116.3 | 119.0 | 81.5 | 80.0 | 178.6 | 191.2 |
| May | 116.8 | 119.6 | 82.3 | 80.3 | 179.5 | 191.4 |
| June | 117.2 | 119.5 | 83.2 | 80.8 | 180.5 | 192.1 |

Fore = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections

## FINANCIAL MARKETS

| | Monetary Base | | M1 | | M2 | | Federal Funds | | T-Bills (6 Mos.) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| January 1987 | 258.8 | 258.9 | 737.6 | 737.7 | 2822.0 | 2822.2 | 6.43 | 6.43 | 5.44 | 5.44 |
| February | 259.3 | 259.0 | 737.2 | 737.5 | 2821.5 | 2821.5 | 6.10 | 6.10 | 5.59 | 5.59 |
| March | 260.5 | 260.1 | 739.2 | 739.5 | 2825.6 | 2824.7 | 6.13 | 6.13 | 5.60 | 5.60 |
| April | 262.0 | 262.2 | 750.1 | 750.4 | 2845.2 | 2839.1 | 6.38 | 6.37 | 6.05 | 5.90 |
| May | 263.3 | 263.4 | 754.4 | 753.2 | 2867.5 | 2840.1 | 6.68 | 6.85 | 6.11 | 6.05 |
| June | 264.5 | 263.8 | 758.7 | 746.7 | 2889.3 | 2842.8 | 6.71 | 6.73 | 6.10 | 5.99 |
| July | 266.4 | 264.3* | 760.4 | 747.1* | 2901.4 | 2854.6* | 6.76 | 6.57* | 6.18 | 5.67* |
| August | 268.2 | 265.1 | 762.5 | 750.3 | 2912.9 | 2868.9 | 6.79 | 6.33 | 6.25 | 5.53 |
| September | 270.0 | 265.9 | 764.6 | 753.0 | 2924.3 | 2883.2 | 6.78 | 6.27 | 6.23 | 5.41 |
| October | 271.3 | 266.7 | 769.3 | 754.8 | 2943.2 | 2892.1 | 6.75 | 6.22 | 6.11 | 5.40 |
| November | 272.6 | 268.3 | 773.9 | 760.9 | 2961.9 | 2908.3 | 6.72 | 6.27 | 6.15 | 5.46 |
| December | 273.6 | 269.9 | 778.5 | 765.4 | 2979.7 | 2925.5 | 6.69 | 6.38 | 6.15 | 5.58 |
| January 1988 | 275.1 | 271.6 | 784.6 | 771.6 | 2995.4 | 2943.1 | 6.57 | 6.55 | 6.01 | 5.73 |
| February | 276.7 | 273.3 | 790.3 | 777.0 | 3014.3 | 2963.7 | 6.55 | 6.62 | 5.98 | 5.81 |
| March | 278.2 | 274.9 | 796.0 | 783.2 | 3033.6 | 2984.4 | 6.61 | 6.76 | 6.06 | 5.92 |
| April | 280.2 | 276.7 | 800.1 | 789.4 | 3049.2 | 3005.3 | 6.76 | 6.88 | 6.17 | 6.01 |
| May | 282.1 | 278.4 | 804.2 | 794.8 | 3064.5 | 3023.3 | 6.88 | 6.85 | 6.30 | 6.06 |
| June | 284.0 | 280.1 | 807.8 | 798.8 | 3079.8 | 3039.9 | 7.01 | 6.97 | 6.32 | 6.11 |

| | Aaa (Seasoned) | | Municipals (Bond Buyer) | | (3 Month) Commercial Paper | | 90 Day CD's | | Prime Rate | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| January 1987 | 8.36 | 8.36 | 6.61 | 6.61 | 5.84 | 5.84 | 5.87 | 5.87 | 7.50 | 7.50 |
| February | 8.38 | 8.38 | 6.61 | 6.61 | 6.05 | 6.05 | 6.10 | 6.10 | 7.50 | 7.50 |
| March | 8.36 | 8.36 | 6.66 | 6.66 | 6.16 | 6.16 | 6.17 | 6.17 | 7.50 | 7.50 |
| April | 8.93 | 8.85 | 7.56 | 7.55 | 6.43 | 6.45 | 6.56 | 6.52 | 7.74 | 7.75 |
| May | 9.20 | 9.33 | 7.82 | 8.00 | 6.72 | 6.93 | 6.81 | 6.99 | 8.19 | 8.14 |
| June | 9.53 | 9.32 | 8.15 | 7.79 | 6.80 | 6.92 | 6.89 | 6.94 | 8.25 | 8.25 |
| July | 9.48 | 9.42* | 8.09 | 7.76* | 6.83 | 6.64* | 6.95 | 6.69* | 8.25 | 8.25* |
| August | 9.50 | 9.36 | 8.10 | 7.68 | 6.85 | 6.30 | 7.02 | 6.37 | 8.25 | 8.25 |
| September | 9.42 | 9.14 | 8.01 | 7.46 | 6.79 | 6.24 | 7.05 | 6.30 | 8.25 | 8.11 |
| October | 9.34 | 9.08 | 7.89 | 7.36 | 6.75 | 6.19 | 7.01 | 6.26 | 8.25 | 8.00 |
| November | 9.29 | 9.16 | 7.80 | 7.47 | 6.70 | 6.28 | 6.97 | 6.34 | 8.25 | 8.00 |
| December | 9.25 | 9.27 | 7.75 | 7.56 | 6.67 | 6.43 | 6.90 | 6.51 | 8.25 | 8.00 |
| January 1988 | 9.12 | 9.42 | 7.62 | 7.73 | 6.54 | 6.62 | 6.74 | 6.69 | 8.25 | 8.00 |
| February | 9.15 | 9.48 | 7.62 | 7.82 | 6.57 | 6.78 | 6.75 | 6.86 | 8.25 | 8.16 |
| March | 9.13 | 9.56 | 7.62 | 7.91 | 6.65 | 6.89 | 6.81 | 6.94 | 8.25 | 8.25 |
| April | 9.32 | 9.55 | 7.85 | 7.88 | 6.78 | 6.95 | 6.99 | 7.03 | 8.25 | 8.38 |
| May | 9.35 | 9.51 | 7.87 | 7.84 | 6.93 | 6.93 | 7.08 | 7.05 | 8.25 | 8.50 |
| June | 9.43 | 9.45 | 7.97 | 7.77 | 7.04 | 7.05 | 7.22 | 7.14 | 8.25 | 8.50 |

* Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections.

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Economic Forecasting Center
College of Business Administration
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MONTHLY PROJECTIONS
August 1987

Dr. Donald Ratajczak, Director
For Release: September 9, 1987

## WHAT SLUGGISH ECONOMY?

On the surface, August's employment report showed a continuation of a relatively moderate economy. Payroll employment increased only 155,000 while the manufacturing workweek remained unchanged. However, surface images sometimes are deceiving. Employment gains in July were more than 300,000, some of which may have been caused by seasonals that are no longer apptopriately reflecting monthly employment patterns. In particular, the apparel and textile industries showed significant employment gains in July followed by employment weakness in August. However, if the July observations are completely ignored, a rising trend in employment prospects in manufacturing appears to be developing. In those industries, increased mechanization virtually has eliminated the old procedure of shutting down the mill in July for vacations. However, the seasonal factors still may be capturing some of that historical behavior. Therefore, activity was overstated in July before more normal behavior returned in August.

Also contributing to the employment weakness was a slight decline in retail employment and marginal employment changes in wholesale trade. Most of the time, a portion of the Labor Day weekend occurs in August. As a result, retailers are increasing their staffs by the time of the employment survey for August. This year, however, Labor Day is unusually late. Thus, the pickup in retail activity may not have materialized as early as expected. This would lead to understating employment gains in August before recapturing these gains in September.

Even with these seasonal distortions, the employment report was stronger than it appeared. The index of hours worked increased by 0.5% in August to 121.2. Hours worked almost certainly will grow more than 3% in the quarter. With little growth in distributive employment, where productivity performance has been especially poor in this cycle, and with a significant increase in the ratio of production to total workers in manufacturing, productivity gains are almost certain this quarter. Thus, the employment report suggests GNP growth

comfortably above 3% probably has developed for the third quarter. As economic activity expanded at nearly a 3.5% rate in the first half of this year, a portrait of a sluggish economy is not developing.

To be sure, some of the strength in economic activity is occurring in inventory rebuilding. Manufacturing inventories increased 0.4% in July and will be a significant contributor to third quarter economic activity. Retail inventories probably diminished as auto incentives once again swelled consumer activity by removing unwanted auto inventory from dealers' lots. Although the trade balances in July could be even worse than those in June, after adjusting for larger price changes for imports than exports, the real trade deficit continued to improve modestly. Only weakness in construction remains to support those looking for a sluggish economy.

To the extent that the consumer is now overextended and must eventually slow spending to more modest rates of income expansion and to the extent that inventory accumulations cannot continue to provide most of the impetus for an economic expansion, this spurt in activity is short-lived. Slower economic growth almost certainly will be forthcoming next year. However, those subsequent possibilities are not as significant in influencing interest rate pressures as current realities. Stronger economic activity has exerted upward pressures upon short-term interest rates.

Unfortunately, a reaccelerating economy at this stage in the business cycle may rapidly run into bottlenecks or longer term supply constraints. In some regions of the country, unemployment rates are hovering near 4%. Although wages are not yet booming in any region, these unusually low unemployment rates are beginning to exert wage pressures. Nationwide, the hourly earnings index increased 0.4% in August and now stands 2.6% above previous year levels. This is a definite increase from the 1.8% year-over-year performance that prevailed early this year. Thus, the beginning of labor market pressures may be apparent in the latest employment statistics.

As the Federal Reserve increased its discount rate in order to forestall inflationary developments, it is possible that these wage rate pressures were uppermost in their concerns. Certainly, other measures of near-term inflationary pressures are beginning to subside. The Journal of Commerce Index of sensitive material prices has averaged just slightly over 99 for the past month. This index peaked in excess of 100 during the spring. Other sensitive commodity prices, except the metals, appear to be down from their spring highs. Our estimates of the PPI for August show no change and the CPI could show a second consecutive 0.2% rate of increase. On the other hand, the dollar has been falling against other currencies, raising the spector of more inflationary pressures down the road.

Most likely, the Federal Reserve wanted to indicate that the Greenspan regime will be as concerned about inflation as the Volcker era. A discount rate increase was long overdue as federal funds rates were trading more than a percentage point above rates at the discount window. Moreover, current strength in the economy precluded any likelihood of reduced short-term interest rates in the months ahead. Thus, some realignment of the discount rate to other short-term interest rates had to be achieved. Moreover, the fed Chairman was going to travel to Basel to meet with other central bankers. Traveling after a discount rate hike would calm calls from his banking peers for more direct Federal Reserve action. Thus, all the factors were in place for the Federal Reserve to increase the discount rate and blame it on rising inflationary pressures.

Unfortunately, bank rates also rose with the increase in the discount rate. This will increase the cost of doing business and will also increase those consumer loans tied to floating rates. Therefore, the Federal Reserve action probably will slow economic activity early next year, especially in the interest-sensitive construction and consumer durables sectors. This increases the likelihood that the economic spurt that currently is developing could be followed by a substantially subdued economic environment sometime in 1988. Moreover, the discount rate still is well behind other short-term interest rates. Therefore, other discount rate increases should be anticipated in the weeks ahead.

Quarterly Profile of GNP

| | 1987-2 | 1987-3 | 1987-4 | 1988-1 | 1988-2 | 1988-3 | 1987 Annual | 1988 Annual |
|---|---|---|---|---|---|---|---|---|
| Real: | 2.3 | 3.7 | 1.9 | 3.3 | 3.0 | 2.0 | 2.6 | 2.7 |
| Price: | 3.8 | 3.7 | 4.6 | 4.0 | 3.9 | 4.9 | 3.3 | 4.3 |
| Nominal: | 6.6 | 7.5 | 6.6 | 7.4 | 7.0 | 7.0 | 6.0 | 7.0 |

Monthly Statistical Highlights for August 1987

Personal income +0.5; savings rate 1.8%; personal consumption +1.5%; retail sales +3.0%; housing starts 0.0%; housing permits +1.1%; construction expenditures -0.1%; business inventories +0.3%; orders for durable goods -0.8%; orders for nondefense capital goods -5.2%; industrial production +0.4%; CPI +0.2%; PPI 0.0%; consumption deflator +0.2%; leading indicators +0.2%; real GNP (AR) +4.2%; M1 (AR) +7.1%; M2 (AR) +5.9%.

Monthly Statistical Highlights for September 1987

Payroll employment +245,000; index of hours worked +0.4%; household employment +262,000; civilian unemployment rate 6.0%; personal income +0.5%; savings rate 1.9%; personal consumption +0.3%; retail sales +0.2%; auto sales 12.0 million units; housing starts -1.5%; housing permits -2.1%; construction expenditures -0.0%; business inventories +0.2%; orders for durable goods -0.3%; orders for nondefense capital goods -1.5%; industrial production +0.2%; CPI +0.4%; PPI +0.2%; consumption deflator +0.3%; leading indicators -0.3%; real GNP (AR) +1.6%; M1 (AR) +6.2%; M2 (AR) +6.3%.

Commentary

Employment - As mentioned above, seasonal factors significantly distorted manufacturing and trade employment in August. Stronger employment gains in both sectors are expected in September. Despite relatively modest increases in payroll employment, increasing hours in the nonmanufacturing sector led to a

relatively strong boost in the index of hours worked. Some anecdotal evidence suggests that part-timers are being replaced by full-timers, leading to slower job growth but increased hours worked and more productive work units.

Next month, the household survey probably will reverse the June pattern, where the labor force was underestimated because of an unusually early survey. In September, a spurt in the labor force probably will develop that could cause a slight increase in the unemployment rate. However, strong growth in employment probably will prevent that from occurring. Nevertheless, a surge in the teenage unemployment rate probably should be anticipated at that time.

Personal Income and Outlays - A 0.8% increase in the hourly wage before adjustment for composition changes almost certainly will cause a significant spurt in wage and salary earnings. Also, the interest rate component should improve significantly. Farm incomes also should be rising. As a result, personal income should rebound in August. This will follow surprisingly weak wage and salary gains in July, when manufacturing earnings actually declined. The cause of this surprising weakness remains unclear. In addition, monthly personal income statistics continued to show a tendancy to understate improvements in interest income. Apparently, tax liabilities will surge during all the quarterly estimating periods, as many taxpayers with significant capital gains income apparently are willing to continue to pay relatively high estimated taxes to prevent penalties for inappropriate estimation. After increasing significantly in June, tax liabilities basically flattened in July. More normal rates of gain are expected in August before another surge in liability develops in September. Because of these high estimated tax payments, the underpayment of taxes as a result of the W-4 withholding problem early in 1988 will be significantly mitigated.

A sharp increase in service expenditures in July appears to be involuntary as a result of unusually hot weather. The weather remained hot in August but should become more seasonal in September. If so, service expenditures should slow at that time. In addition, the stock market is no longer generating the same volume of activity as earlier. This will reduce the imputed financial services incorporated in the services expenditures component.

Retail Sales - Sales of hardware and furniture were substantially stronger than anticipated in July. Stronger sales growth probably will occur than contained in our forecast. However, as housing activity slows, these sales also are expected to slow early in 1988.

Automobile sales once again are responding to substantial incentives. The sales may be partially distorted as a result of the unusually late Labor Day period. As a result, the last ten days of August appeared to show a dramatic slowing in automobile sales. However, a pickup in sales may occur during the Labor Day week in early September. Other retail sales may also be impacted by this seasonal distortion. Later in the month, a reduction in incentive related cars should slow automobile sales. A plunge in sales then is anticipated in the fall before a return to more normal rates of growth develop early in 1988.

Construction - Although single-family starts rebounded in July, housing permits for single-family units were unusually weak. Apartment starts were weak but permits strengthened. As a result, apartment activity may stabilize near the 450,000 - 470,000 unit level for the remainder of this year. However, single-family units are expected to be adversely effected as mortgage interest rates

reach 11%. This insures a more sluggish housing market than originally anticipated. However, higher housing prices will lead to greater dollar values for residential construction than contained in the forecast. Only late in 1988 will the reduced units currently projected lead to greater sluggishness in residential construction expenditures.

Public construction has been surprisingly weak in the past few months following a surge in highway activity earlier in the year. Some of this weakness appears to be related to problems associated with the tax-exempt market. Many municipalities are reluctant to float tax-exempt bonds because of the anti-arbitrage rules that the treasury has imposed upon them. This appears to be having an adverse effect upon public construction activity and is expected to restrain that activity below our forecasted values. Nonresidential activity appears to be falling more rapidly than construction contracts suggest. Of course, weakness was anticipated as a result of changes in the tax codes. Nevertheless, the FW Dodge contract series shows no decline in contracts during the first half of 1987. Typically, this would mean that contract construction would not decline until six to nine months later. However, some of these contracts are not being utilized and construction is falling significantly. Weakness appears to be widespread in all sectors of construction with the exception of industrial activity.

Business Activity - Manufacturing orders spurted in July as a result of increased delivery delays. Further increases in manufacturing orders probably will develop through the remainder of this year. This is adding an area of strength to industrial activity that previously did not exist.

The spurt in orders for nondefense capital goods only partially reflects unusually large commercial aircraft orders. This commercial aircraft will not be delivered until the end of this decade, and, therefore, has little impact upon near-term capital spending activity. However, machinery is beginning to rebound as domestic producers once again are becoming competitive with foreign competition. Nondefense capital goods should show stronger gains than originally anticipated.

On the other hand, weakness in defense shipments during July is not easy to determine. Orders remain more than $1 billion above shipments, suggesting that further growth in shipments should be forthcoming.

Seasonal problems associated with manufacturing employment also are distorting the industrial production series. Industrial production could increase at a much slower rate in the next two months than currently projected. It is noteworthy, however, that industrial production has spurted much more rapidly in the past few months than expected in our August forecast.

Prices - Oil prices appear to have peaked, although the rate of descent remains slow. Most oil product prices did not respond to the latest spurt in crude petroleum prices and, therefore, are not likely to fall significantly unless crude prices decline below $18 per barrel. Current demand-supply conditions in world oil markets suggest that a temporary price plunge below $18 is likely. However, a rebound above the $18 level should develop before winter begins. Moreover, increasing world demand and reduced world supply should maintain prices above $18 per barrel through 1988 and cause prices to gradually head higher in subsequent years.

Meat prices also have stabilized after a spring and early summer spurt. As a result, commodity prices are expected to grow at a relatively slow rate through much of the fall. An acceleration in commodity inflation then is anticipated in the winter and spring months. Nevertheless, inflation appears to be developing at a slower rate than expected in our August forecast. The only exception to this is the dramatic acceleration in the construction deflator. A sharp 0.7% gain in that deflator during July is not expected to persist, as it apparently was caused by a temporary tightening in lumber supply. As construction diminishes, however, the construction deflator should grow at much more moderate rates.

Miscellaneous - The leading indicators have been bolstered by continuing gains in the stock market and a spurt in the smoothed sensitive price series. Unfortunately, that sensitive prices series is very heavily weighted by the lumber component and should not be considered as a signal of early inflationary surges. In 1984, that measure of sensitive prices rose dramatically without being a harbinger of rising inflation. Moreover, those sensitive prices probably are beginning to diminish in intensity. Therefore, the leading indicators will have some difficulty moving further forward. Vendors' performance also has been adding to the indicators in the past few months but is unlikely to continue so dramatically. Even so, the indicators already are significantly above where they should have been relative to the variables forecast in our August analysis.

The trade balances are developing worse than expected only a month ago. Both the value and volume of oil is significantly adding to the imbalances. However, economic strength also is pulling in a lot of imports. This indicates that the trade balances will be much higher and require a greater adjustment in currency values than originally anticipated.

## Financial Markets

Strengthening economic activity has placed upward pressures upon short-term interest rates. For this reason, it became apparent that the gap between the federal funds rate and the discount rate would not be closed by an easing of general short-term interest rates. Indeed, the current discount rate increase is not sufficient to eliminate the gap. Interest rate pressures are still intensifying as a result of increased inventory accumulations. In the latest reporting week, the commercial paper rate exceeded the federal funds rate by ten basis points. Such an increase usually suggests that credit market demand pressures are creating higher rates. Because of these increased pressures it is apparent that no dip in short-term interest rates is likely over the next year. Indeed, further increases in short-term interest rates could develop if inventory accumulations remain intense through the fourth quarter. Our current projections suggest that inventory accumulations will moderate at that time, however.

One other problem remains, as the discount rate still is too far below the federal funds rate. Thus, another increase in the discount rate in the near future, probably to defend the dollar's value, should be anticipated. If this discount rate move is merely for psychological purposes and does little to exert upward pressures on other short-term interest rates, there is no reason why the prime rate should move up further. However, banks may try to use a discount rate move to widen their spread. Therefore, a prime rate in excess of 9% may occur before year's end.

Long-term interest rates also are being pressed upward. The increase in these rates is more difficult to explain as near-term inflationary pressures are not intensifying. On the other hand, inflationary danger signals are beginning to develop. In particular, acceleration in the hourly earnings index must be viewed with some concern. Also, the dollar's weakness probably indicates more inflationary pressures into 1988. The credit markets are clearly anticipating intensified inflationary problems. Again, interest rates could rise further than currently being projected as these inflationary fears intensify. On the other hand, there is no evidence that the fears are supported by reality.

Our analysis by sector shows some reasons for rising interest rates but only very marginally. The government sector has been reducing its credit market pressures as deficits gradually have been diminishing. However, those deficits are expected to increase in the year ahead. The corporate sector is significantly increasing its use of funds as inventory activity increases and as capital spending also intensifies. However, internally generated funds are also growing rapidly. Therefore, the net position of the corporate sector probably will be relatively unchanged through much of the next year. The household sector has dramatically been reducing their contributions to the credit market. Savings rates have plunged with the increase in automobile sales. This reduced contribution to the credit markets may very well be a contributing factor to higher rates of interest. However, the major source of rising interest rates appears to be the increased reluctance of foreign investors to purchase financial assets in the United States. This reluctance is largely the result of a narrowing in the interest rate spread between yields in the United States and abroad. As these spreads narrowed, the attractiveness of American assets has been reduced. Thus, some widening of the spreads in the form of higher U.S. interest rates may be necessary before foreign investors again provide their normal share of contributions to our credit markets.

Equity Markets - Normally, rising short-term interest rates and a significant increase in long-term interest rates would be the death knell of a bull market. Ultimately, rising equity values will be coming to an end, as the combined facts of higher financing costs reducing the earnings potential of corporations and the reduced value of earnings associated with rising bond yields begins to discourage equity investors. Only obvious valuations, such as the improving capital goods, textile, and plastics industries or substantial development stories should justify investment at this time. Most investors should begin a defensive approach to their investment activities with the view that stock prices could fall in value as rapidly as bond prices have done in recent weeks.

## EMPLOYMENT

| | Payroll Employment | | Index of Hours Worked | | Household Civilian Employment | | Civilian Unemployment Rate | | Hourly Earnings Index | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| April 1987 | 101598 | 101598 | 119.6 | 119.6 | 111835 | 111835 | 6.3 | 6.3 | 172.6 | 172.6 |
| May | 101672 | 101708 | 120.2 | 120.2 | 112447 | 112447 | 6.3 | 6.3 | 172.7 | 172.9 |
| June | 101788 | 101818 | 120.1 | 120.0 | 112257 | 112257 | 6.1 | 6.1 | 173.1 | 172.9 |
| July | 101973 | 102114 | 120.4 | 120.6 | 112462 | 112727 | 6.2 | 6.0 | 173.5 | 173.2 |
| August | 102150 | 102270 | 120.6 | 121.2 | 112653 | 113081 | 6.1 | 6.0 | 173.9 | 173.9 |
| September | 102327 | 102515* | 120.9 | 121.7* | 113171 | 113343* | 6.2 | 6.0* | 174.5 | 174.3* |
| October | 102485 | 102701 | 120.9 | 121.9 | 113029 | 113406 | 6.3 | 5.9 | 174.7 | 174.6 |
| November | 102628 | 102889* | 121.0 | 122.1 | 113292 | 113618 | 6.3 | 5.9 | 175.0 | 174.9 |
| December | 102771 | 103062 | 121.2 | 122.2 | 113556 | 113816 | 6.2 | 5.9 | 175.2 | 175.2 |
| January 1988 | 102965 | 103247 | 121.4 | 122.5 | 113769 | 114036 | 6.2 | 5.8 | 175.8 | 175.6 |
| February | 103163 | 103425 | 121.7 | 122.7 | 113970 | 114247 | 6.2 | 5.8 | 176.6 | 176.0 |
| March | 103360 | 103603 | 122.1 | 122.9 | 114173 | 114484 | 6.1 | 5.7 | 177.4 | 176.5 |
| April | 103526 | 103784 | 122.2 | 123.1 | 114388 | 114706 | 6.2 | 5.7 | 177.8 | 177.1 |
| May | 103693 | 103956 | 122.4 | 123.2 | 114595 | 114909 | 6.2 | 5.6 | 178.3 | 177.8 |
| June | 103860 | 104142 | 122.5 | 123.4 | 114804 | 115105 | 6.1 | 5.6 | 178.9 | 178.5 |
| July | 104051 | 104327 | 122.7 | 123.6 | 114992 | 115325 | 6.1 | 5.6 | 179.5 | 179.2 |
| August | 104225 | 104516 | 123.0 | 123.8 | 115134 | 115538 | 6.0 | 5.5 | 180.1 | 179.8 |
| September | 104400 | 104706 | 123.3 | 124.0 | 115276 | 115770 | 6.1 | 5.5 | 180.7 | 180.5 |

## PERSONAL INCOME

| | Personal Income | | Wage & Salary | | Personal Savings | | Disposable Income | | Personal Outlays | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| April 1987 | 3.700 | 3.704 | 2.182 | 2.182 | 32.9 | 42.3 | 3.067 | 3.070 | 3.034 | 3.028 |
| May | 3.718 | 3.713 | 2.193 | 2.194 | 146.4 | 136.7 | 3.176 | 3.171 | 3.030 | 3.035 |
| June | 3.731 | 3.723 | 2.201 | 2.200 | 122.3 | 102.9 | 3.173 | 3.165 | 3.050 | 3.062 |
| July | 3.749 | 3.738 | 2.211 | 2.205 | 122.8 | 88.9 | 3.190 | 3.177 | 3.067 | 3.088 |
| August | 3.765 | 3.756* | 2.220 | 2.216* | 119.5 | 57.4* | 3.204 | 3.191* | 3.085 | 3.134* |
| September | 3.782 | 3.773 | 2.228 | 2.226 | 99.3 | 59.5 | 3.220 | 3.203 | 3.121 | 3.144 |
| October | 3.795 | 3.793 | 2.236 | 2.238 | 111.2 | 116.8 | 3.229 | 3.219 | 3.118 | 3.102 |
| November | 3.809 | 3.810 | 2.244 | 2.248 | 105.0 | 102.7 | 3.238 | 3.231 | 3.133 | 3.128 |
| December | 3.825 | 3.826 | 2.252 | 2.256 | 100.8 | 88.3 | 3.249 | 3.243 | 3.148 | 3.155 |
| January 1988 | 3.834 | 3.839 | 2.265 | 2.266 | 128.7 | 110.3 | 3.296 | 3.283 | 3.167 | 3.173 |
| February | 3.855 | 3.858 | 2.277 | 2.279 | 124.9 | 120.4 | 3.308 | 3.305 | 3.183 | 3.185 |
| March | 3.886 | 3.875 | 2.290 | 2.290 | 111.7 | 116.3 | 3.315 | 3.319 | 3.203 | 3.203 |
| April | 3.907 | 3.897 | 2.301 | 2.304 | 117.3 | 120.0 | 3.336 | 3.337 | 3.219 | 3.217 |
| May | 3.919 | 3.918 | 2.313 | 2.316 | 121.3 | 117.8 | 3.353 | 3.354 | 3.232 | 3.236 |
| June | 3.931 | 3.941 | 2.325 | 2.331 | 122.7 | 123.5 | 3.370 | 3.373 | 3.247 | 3.250 |
| July | 3.955 | 3.962 | 2.337 | 2.345 | 120.1 | 123.8 | 3.383 | 3.389 | 3.263 | 3.265 |
| August | 3.978 | 3.984 | 2.349 | 2.359 | 112.8 | 124.3 | 3.397 | 3.406 | 3.284 | 3.282 |
| September | 4.001 | 4.006 | 2.361 | 2.373 | 109.2 | 121.8 | 3.411 | 3.423 | 3.302 | 3.301 |

Fore. = August Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections

## CONSUMPTION

| | Personal Consumption | | Durables | | Nondurables | | Services | | Consumption Real | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| April 1987 | 2939.7 | 2933.8 | 411.6 | 408.1 | 979.3 | 976.8 | 1548.8 | 1548.9 | 2497.0 | 2488.1 |
| May | 2935.9 | 2940.6 | 403.8 | 402.3 | 977.3 | 983.4 | 1554.7 | 1555.0 | 2481.2 | 2482.1 |
| June | 2956.3 | 2967.5 | 413.6 | 412.1 | 974.4 | 986.8 | 1568.3 | 1568.6 | 2487.9 | 2496.8 |
| July | 2973.2 | 2993.1 | 414.3 | 418.0 | 979.5 | 992.0 | 1579.4 | 1583.1 | 2492.2 | 2511.7* |
| August | 2990.1 | 3038.4* | 412.8 | 449.5* | 988.3 | 996.3* | 1589.0 | 1592.6* | 2498.0 | 2546.2 |
| September | 3025.9 | 3047.9 | 429.6 | 446.6 | 997.7 | 1000.8 | 1598.6 | 1600.5 | 2521.6 | 2546.2 |
| October | 3022.6 | 3006.2 | 415.5 | 390.9 | 1000.6 | 1005.6 | 1606.5 | 1609.7 | 2510.5 | 2496.5 |
| November | 3037.5 | 3031.8 | 419.4 | 403.8 | 1002.6 | 1009.5 | 1615.5 | 1618.5 | 2516.6 | 2511.5 |
| December | 3052.4 | 3057.7 | 423.4 | 416.6 | 1004.7 | 1013.8 | 1624.3 | 1627.3 | 2522.6 | 2525.3 |
| January 1988 | 3071.3 | 3075.4 | 425.8 | 420.2 | 1010.6 | 1018.4 | 1634.9 | 1636.8 | 2527.8 | 2532.3 |
| February | 3087.0 | 3087.0 | 422.7 | 419.1 | 1018.9 | 1022.0 | 1645.4 | 1645.9 | 2532.4 | 2534.5 |
| March | 3107.3 | 3104.7 | 424.4 | 422.0 | 1026.9 | 1026.5 | 1656.0 | 1656.2 | 2538.8 | 2540.0 |
| April | 3122.3 | 3118.6 | 427.1 | 424.0 | 1030.4 | 1031.5 | 1664.8 | 1663.1 | 2540.5 | 2543.8 |
| May | 3135.0 | 3137.4 | 427.5 | 427.4 | 1033.6 | 1037.1 | 1673.9 | 1672.9 | 2542.6 | 2551.7 |
| June | 3152.8 | 3150.3 | 433.0 | 427.2 | 1036.8 | 1041.7 | 1683.0 | 1681.4 | 2548.7 | 2551.8 |
| July | 3170.9 | 3165.6 | 438.8 | 426.3 | 1042.5 | 1047.1 | 1694.6 | 1692.2 | 2553.1 | 2553.9 |
| August | 3186.7 | 3181.7 | 432.5 | 427.0 | 1048.3 | 1051.3 | 1705.9 | 1703.4 | 2555.5 | 2556.0 |
| September | 3204.0 | 3200.8 | 432.7 | 428.9 | 1054.1 | 1056.6 | 1717.2 | 1715.3 | 2561.2 | 2561.6 |

## RETAIL SALES

| | Retail Sales | | Non-Auto Durables | | Auto (Million Units) | | Nondurable Sales | | Auto Sales | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. | Fore. | C.E. |
| April 1987 | 124.96 | 124.96 | 20.03 | 20.03 | 10.4 | 10.5 | 76.83 | 76.83 | 28.10 | 28.10 |
| May | 124.55 | 124.87 | 20.07 | 20.00 | 9.7 | 9.9 | 76.86 | 77.08 | 27.61 | 27.78 |
| June | 125.08 | 126.62 | 19.98 | 20.05 | 10.2 | 10.2 | 76.97 | 77.54 | 28.13 | 29.04 |
| July | 125.60 | 127.57 | 20.30 | 20.15 | 10.2 | 10.5 | 77.08 | 77.82 | 28.22 | 29.60 |
| August | 126.12 | 131.40* | 20.19 | 20.26* | 10.1 | 12.3* | 77.78 | 78.16* | 28.15 | 32.98* |
| September | 128.83 | 131.66 | 20.07 | 20.30 | 11.0 | 12.0 | 78.52 | 78.51 | 30.24 | 32.85 |
| October | 127.33 | 125.41 | 20.27 | 20.37 | 9.6 | 8.9 | 79.17 | 78.89 | 27.89 | 26.15 |
| November | 128.01 | 127.25 | 20.34 | 20.44 | 10.0 | 9.4 | 78.90 | 79.19 | 28.77 | 27.62 |
| December | 129.15 | 129.11 | 20.02 | 20.50 | 10.5 | 10.0 | 79.07 | 79.53 | 30.06 | 29.08 |
| January 1988 | 129.39 | 129.90 | 20.02 | 20.58 | 10.4 | 10.2 | 79.53 | 79.89 | 29.84 | 29.43 |
| February | 129.68 | 130.05 | 19.94 | 20.61 | 10.2 | 10.1 | 80.18 | 80.17 | 29.56 | 29.27 |
| March | 130.51 | 130.76 | 19.97 | 20.68 | 10.3 | 10.2 | 80.81 | 80.53 | 29.73 | 29.55 |
| April | 131.10 | 131.38 | 20.09 | 20.73 | 10.4 | 10.3 | 81.09 | 80.92 | 29.92 | 29.73 |
| May | 131.40 | 132.23 | 20.08 | 20.79 | 10.4 | 10.5 | 81.34 | 81.36 | 29.98 | 30.08 |
| June | 132.30 | 132.57 | 20.52 | 20.70 | 10.5 | 10.5 | 81.59 | 81.72 | 30.19 | 30.15 |
| July | 132.84 | 132.88 | 20.75 | 20.72 | 10.4 | 10.4 | 82.04 | 81.14 | 30.05 | 30.02 |
| August | 133.15 | 133.29 | 20.69 | 20.75 | 10.3 | 10.4 | 82.50 | 82.47 | 29.96 | 30.07 |
| September | 133.62 | 133.94 | 20.65 | 20.79 | 10.3 | 10.5 | 82.95 | 82.89 | 30.02 | 30.26 |

Fore. = August Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections.